In the Supreme Court of the United States.

OCTOBER TERM, 1922.

HARRY H. WEISS, COLLECTOR OF INTERNAL REVENUE, petitioner,
v.
LOUIS STEARN, RESPONDENT.

No. —.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT, AND BRIEF IN SUPPORT THEREOF.

The Solicitor General, on behalf of Harry H. Weiss, Collector of Internal Revenue, prays that a writ of certiorari issue to review the judgment of the Circuit Court of Appeals for the Sixth Circuit rendered in the above-entitled case on January 9, 1923, affirming a judgment entered by the District Court allowing the respondent to recover taxes paid under protest.

STATEMENT.

This is an action brought by the respondent to recover taxes assessed and paid to the Government, under protest, by virtue of the Revenue Law of 1916 (39 Stat. 757), upon shares of stock received in the National Acme Company growing out of an

apparent sale and termination of the National Acme Manufacturing Company.

This case was tried in the District Court and resulted in a judgment for the respondent. The Circuit Court of Appeals, taking the view that the transaction was merely a reorganization accompanied by a stock dividend, affirmed the judgment. Petitioner now seeks to have this judgment of the Circuit Court of Appeals affirming the judgment of the District Court reviewed by certiorari.

QUESTION INVOLVED.

The sole question involved is whether the respondent should be regarded for the purpose of income taxation under the Revenue Law of 1916 (39 Stat. 757) as having disposed of, with profit, only one-half of his respective holdings in the National Acme Manufacturing Company, or whether he should have been considered as having so disposed of the entirety.

THE FACTS.

Under a contract between the stockholders of the National Acme Manufacturing Company and Eastman, Dillon & Company, the stockholders sold all of the stock in the National Acme Manufacturing Company to the latter company and received for each share of the old stock $150 in cash and five shares in a newly organized "National Acme Company." Eastman, Dillon & Company, by virtue of this transaction, acquired a one-half interest in the newly organized company.

The petitioner contends that the profit was the difference between the March 1, 1913, value of the stock of the old National Acme Manufacturing Company and the entire consideration received in exchange therefor, consisting of cash and stock of the new National Acme Company.

REASONS FOR GRANTING THE PETITION.

1. The decision of the Circuit Court of Appeals is detrimental to the interests of the Government in the collection of revenue under the Revenue Law of 1916, as it is directly opposite to the ruling of the Treasury Department in pursuance of which large amounts of taxes have already been collected. If the decision stands, numerous other suits may be expected, with strong possibility of conflicting decisions in other circuits.

2. The question is of grave importance to the administration of the Internal Revenue Laws, which this decision leaves in great confusion.

3. The Circuit Court of Appeals erred in holding that the distribution upon reorganization of the new stock in exchange for the old did not involve taxable income.

JAMES M. BECK,
Solicitor General.

BRIEF IN SUPPORT OF THE PETITION.

I.

The court erred in holding that while as to one-half of the stock in the National Acme Manufacturing Company there was a sale from which the stockholders derived taxable income, yet as to the other half of the stock there was an exchange of stock for stock out of which exchange the old stockholders of the National Acme Manufacturing Company received no taxable income, but only a stock dividend.

The stockholders sold their shares in the National Acme Manufacturing Company for $150 cash and five (5) shares of stock in the new company for each share of stock in the old, the assets of the old company, including surplus, having been transferred to the new company. Certainly the undivided interest of the individual stockholder in the surplus accumulated had been released to and drawn by him as profit or income from his original capital investment. The distribution in stock to the stockholders of the National Acme Manufacturing Company resulted in taxable income regardless of the fact that this company was dissolved and never continued as a going concern after said distribution. The distribution in the present case can not be said to be a stock dividend, for in *Eisner* v. *Macomber*, 252 U. S. 189, 202, 203, it is stated that the essentials of a true stock dividend are that "a stock dividend really takes nothing from

the property of the corporation, and adds nothing to the interests of the shareholders. Its property is not diminished, and their interests are not increased. * * * The proportional interest of each shareholder remains the same."

In the present case the transaction was a sale of all the stock of the National Acme Manufacturing Company and while the corporate assets may have been the same upon its completion as they were at its inception, it is certainly not true that the stockholding interests were identical. It is believed that this question has been conclusively settled by the case of *United States* v. *Phellis*, 257 U. S. 156, wherein it was held that the distribution constituted a property dividend and was taxable as such in the hands of the stockholders. The court pointed out (p. 169) that—

> Hence the inquiry must be whether the shares of stock in the new company received by claimant as a dividend by reason of his ownership of stock in the old company constituted (to apply the tests laid down in *Eisner* v. *Macomber*, 252 U. S. 189, 207), a gain derived from capital, not a gain accruing to capital, nor a growth or increment of value in the investment, but a gain, a profit, something of exchangeable value proceeding from the property, severed from the capital however invested, and coming in, that is, received or drawn by the claimant for his separate use, benefit and disposal.

The distribution in question surely resulted in taxable income to the stockholders of the old company in the form of profit derived from the sale and exchange of their shares of stock in the National Acme Manufacturing Company for shares of stock in the National Acme Company and cash. The measure of the profit, gain, and income so derived is the difference between the fair market value of the stock of the National Acme Manufacturing Company on March 1, 1913, and the value of the entire consideration received in payment thereof, i. e., five shares of stock of the National Acme Company and $150 in cash for each share of stock of the National Acme Manufacturing Company.

Merchants Loan & Trust Company v. *Smietanka*, 255 U. S. 509.
Goodrich v. *Edwards*, 255 U. S. 527.
Walsh v. *Brewster*, 255 U. S. 536.

CONCLUSION.

It is respectfully submitted that a writ of certiorari should issue to review the judgment of the Circuit Court of Appeals for the Sixth Circuit to the end that it may be reversed.

JAMES M. BECK,
Solicitor General.

MABEL WALKER WILLEBRANDT,
Assistant Attorney General.

JOHN C. HAYES,
Special Assistant to the Attorney General.

APRIL, 1923.

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